No. 11548

IN THE

United States Circuit Court of Appeals

FOR THE NINTH CIRCUIT

STIMSON MILL COMPANY,

Petitioner.

VS.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

ON PETITION FOR REVIEW OF THE DECISION OF THE TAX COURT OF THE UNITED STATES.

Petition for Rehearing.

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MAY IT PLEASE THE COURT:

We respectfully urge that the Court reached its decision through a misapprehension of the effect of the "in lieu of" clause in the 1942 amendments of section 722 which in substance was not new but replaced a parallel clause of similar effect in the 1941 enactment—a clause which substituted the constructive average for the average under section 713 (e) but did not affect the statutory requirement of the 1941 enactment that the constructive average should be computed "in the same manner" as the average in section 713 (e).

We respectfully submit that the Court has misapprehended the significance and effect of the words, "a fair and just amount," and of our arguments regarding those words and regarding other statutory provisions.[1]

Pohatcong Hosiery Mills, Inc. v. *C. I. R.,* CCA 3, decided May 23, 1947, is cited by the Court on propositions of law with which we agree, but we feel that we should call the Court's attention to the fact, which the Court may have overlooked, that no claim for refund was before the Court in the *Pohatcong* case to form the basis of a decision regarding procedure to be followed for the realization of relief on such a claim. On the second page of the opinion in the *Pohatcong* case, italicized language, referred to on oral

[1] Although the Brief for the Respondent herein was directed only to the jurisdiction question and not to the merits question, nevertheless Counsel for the Commissioner, on oral argument based on the Brief for the Respondent, in answer to a question asked by Honorable Judge Stephens, admitted that he was also arguing the merits. Under such circumstances we respectfully submit that the Reply Brief for Petitioner which was directed to the points made in the Brief for the Respondent, should also be considered as a reply on the merits as well as on the jurisdiction question. Since we did not know at the time we wrote the reply brief that the Commissioner was also arguing the merits, we of course were not able to reply fully with respect to the merits in the reply brief. But the questions both on the jurisdiction and on the merits involved many of the same problems of statutory construction, and our reply brief to some extent replies on the merits. This is true particularly of the interpretation to be given the words, "a fair and just amount representing normal earnings to be used as a constructive average base period net income," which were argued in the Brief for the Respondent. We respectfully submit that our position on questions of statutory interpretation must necessarily be the same whether directed to the jurisdiction or to the merits, and that in view of the fact that the Commissioner's arguments were on the merits as well as on the jurisdiction, the Reply Brief for Petitioner should be taken as a reply on the merits as well as on jurisdiction.

argument, shows the determination of the Commissioner, pursuant to section 722 (d), that "these applications do not constitute claims for refund," and the Court in that case does not show that section 732 (c) does not preclude review of the Commissioner's determination. The *Pohatcong* case, however, is not involved in this Petition for Rehearing.

We realize that it is not the purpose of a petition for rehearing to reargue the case and accordingly we will attempt to limit ourselves to pointing out the following specific points in the briefs which we believe the Court has overlooked and which we respectfully submit are inconsistent with the decision reached by the Court.

I.

The Court has overlooked the fact, argued by petitioner, that the "in lieu of" clause in the 1942 amendments of section 722 merely replaced a clause of similar meaning in the 1941 Act and did not change the requirements of the 1941 enactment that constructive average base period net income be computed in the same manner as provided by section 713 (e). A comparison of these parallel provisions of the two enactments was made at page 39 of the Brief for Petitioner where it was shown that section 722(a) of the 1941 Act concludes by stating:

> ". . . the amount established under paragraph (3)" (namely the constructive average) "shall be considered as the average base period net income of the taxpayer for the purposes of this subchapter."

The "in lieu of" clause of the 1942 Act, and the parallel provision of the 1941 Act, both require substitution of the constructive average base period net income in lieu of the average computed under section 713 (e). In substance the "in lieu of" clause of the 1942 Act was not an alteration of the 1941 Act.

The court misapprehended point IV of the Brief for Petitioner, pp. 38-40. The "in lieu of" clause was explained in conjunction with the provision of the 1942 Act that normal earnings be used "as" a constructive *average base period net income* which is parallel in effect to the provision in section 722 (b) (3) of the 1941 Act that the reconstructed earnings be computed "in the same manner as provided in" section 713 (e). The fact is that under both Acts the manner of computation of the average for constructive normal earnings was the same as provided by section 713 (e), even though such constructive average base period net income was to be used in both Acts in lieu of the average otherwise determined under section 713 (e).

The Court at page 11 of its opinion states: "The constructive average of § 722 is to be used in lieu of the § 713 (e) (1) average; hence it cannot be the same average as that called for in § 713 (e) (1)." It is respectfully submitted that Petitioner has never intended to argue and has not argued to the contrary. The average in section 722 must be substituted for the average in section 713 (e). But the average in section 722 is a constructive "average base period net income" which is defined in section 713 (e). It is not an average base period constructive net income, or an arithmetic average, or anything other than a constructive *average base period net income.* When the method of computation prescribed by the definition of average base period net income in section 713 (e) is applied to recon-

structed earnings, the amount resulting is *not* the same average prescribed by that section; the result is a constructive average base period net income, which, in view of the parallel provisions of the 1941 enactment, is the result which the 1942 statute intended.

II.

The Court has disregarded the fact that the committee reports on the 1942 Act repeated the same legislative purpose which had been the aim of Congress in the 1941 enactment of section 722. The Court's attention is respectfully called to the quotation from the committee reports on page 35 of the Brief for Petitioner where the equitable considerations which motivated the 1941 enactment were emphasized in view of the increase in tax rates in 1942 and "the need for expanding the application of the relief section". The fact that the same legislative purpose motivated both enactments was also called to the Court's attention at page 6 of the Reply Brief for Petitioner.

III.

The Court has overlooked the fact that subsection (c) taken with subsection (b) of section 722, shows that a taxpayer is "entitled to use" section 713 and its subsections after qualifying for relief, such fact being one of the grounds for petitioner's argument that "constructive average base period net income" should be construed with the definition in section 713 (e). *Bickford* ("Excess Profits Tax Relief", pp. 21, 22; 1944; Prentice-Hall) does not mention the fact shown by petitioner that under section 722 (c) corporations not entitled to use section 713, become entitled to use section 713 after they qualify for relief under section 722 (Br. Pet. pp. 32, 33).

Petitioner's argument that sections 722 and 713 "must accordingly be construed together" (Br. Pet. p. 33) does not conflict with the fact that the constructive average must be used in lieu of the average in section 713 (e). (In the Reply Brief we pointed out the confusing use of terms by the respondent, but it now appears that we inadvertently have also been at fault.) Throughout the brief the method of construing the sections together is indicated; the constructive average base period net income must be computed "in the same manner" as provided in section 713 (e) or "in accordance with" section 713 (e) (Br. Pet. pp. 3, 16, 23, 24, 33, 38, 39, 53, 56, 60, 67, 73). "The 'normal earnings' of section 722 (a) are to be used as provided by the definition of 'average base period net income' " (Rep. Br. Pet. p. 5).

IV.

The Court has overlooked the fact that the computation of the constructive average is only a purely ministerial duty and that such ministerial duty renders untenable the Commissioner's regulations that "The constructive average base period net income is a fair and just amount representing normal earnings".

At page 13 of the Reply Brief for Petitioner it was shown that the Commissioner's evasive answer (Br. Resp. pp. 23, 10) "does not deny that the computation of the average is only a purely ministerial duty." The Commissioner's regulations that the "constructive average . . . is a fair and just amount", do not recognize the fact that the computation of the average is a ministerial duty. The words, "fair and just amount", are words of discretion. The computation of the average is not discretionary (Cf. Br. Pet. pp. 57-59).

It is respectfully submitted that the Court misapprehended these facts in stating at page 7 of the opinion: "On the other hand 'constructive average base period net income' is established by the *discretionary* use of rules and methods . . . .". (Emphasis was supplied by the Court.)

V.

The Court at page 8 of its opinion considers petitioner's alternative point "that there is no evidence that an average computed under §713 (e) (1) is *not* a fair and just amount." But in so doing it is respectfully submitted that the Court has overlooked other arguments of petitioner, respecting the meaning of "a fair and just amount", as follows:

1. The statute provides for "a fair and just amount representing *normal earnings*" and not a fair and just amount representing a *constructive average* (Br. Pet. p. 38; Rep. Br. Pet. p. 1 et seq.)

2. "A fair and just amount" represents "normal earnings", and "normal earnings" are not an average (Rep. Br. Pet. pp. 4, 5, 8, 9).

3. The Commissioner's discretion ends with the determination of a fair and just amount representing normal earnings, and the computation of the average, whether an ordinary arithmetic average or the average in accordance with section 713 (e), is only a ministerial duty concerning which the Commissioner has no discretion (Br. Pet. pp. 75-77; Rep. Br. Pet. pp. 10-14, particularly page 13). The words, "a fair and just amount", are words of discretion, but they do not permit any deviation from the computation which is a ministerial duty prescribed by statute (Br. Pet. pp. 75-77; Rep. Br. Pet. p. 12.)

4. The computation prescribed by section 713 (e) can-

not be tested as to whether it is a fair and just amount because it is a "standard of normal earnings", which, while based on normal earnings, is an automatic formula entering into the computation of the tax. A substituted constructive standard of normal earnings pursuant to section 722 (a) produces an erroneous tax computation if it does not conform to the prescribed standard (Br. Pet. pp. 42, 43, top of p. 68, 73; Rep. Br. Pet. pp. 7-9). The fairness of the required standard for the tax computation "is not subject to question here any more than the fairness of the excess profits tax" (Rep. Br. Pet. p. 9).

VI.

The Court has overlooked the fact that the automatic raising of earnings for the year 1938 is a result of the method prescribed by section 713 (e) for the computation of the tax. If petitioner had had no strike in 1937 its average base period net income as a matter of fact would have been $89,539.31. After correction of the 1937 earnings under section 722 to what they would have been in the absence of a strike, the automatic increase of the year 1938 is also properly corrected when the constructive average is computed in accordance with the method prescribed by section 713 (e) and the resulting constructive average of $89,539.31 produces the equitable result of relieving the petitioner from the abnormal results of the strike. The need of making the automatic correction for the year 1938 was shown at pages 7 and 8 of the Reply Brief for Petitioner.

Section 722 (b) (1) states that normal earnings may be redetermined for one year. But if the automatic method of computing the tax prescribed by the definition in section 713 (e) is not followed, the relief statute is construed to deprive the petitioner of relief (Br. Pet. pp. 15, 16, 52-56).

VII.

In stating at page 6 of the opinion that "By stipulation he established the right to raise the 1937 figures under § 722, and by stipulation he was not entitled to raise other years under that section", the Court overlooks the principle that parties may stipulate only as to facts and not as to the legal effect to be given such facts (*Sanford's Estate* v. *C. I. R.*, 1939, 308 U. S. 39, 51, 84 L. ed. 20, 26).

VIII.

The fact that the relief provisions of section 722 represent sovereign gracious clemency on the part of Congress, is recognition of the remedial nature of such provisions. It is respectfully urged that in this situation the application of the principle of liberal construction has been overlooked by the Court. The application of that principle was argued at pages 50 and 51 of the Brief for Petitioner. The quotation at page 51 from *Bonwit Teller & Co.* v. *United States*, 1931, 283 U. S. 258, 263, 75 L. ed. 1018, 1021, that a relief provision in a tax law "is to be construed liberally in favor of the taxpayers to give the relief it was intended to provide", is supported by ample authority cited by the Supreme Court.

The Court at page 11 of the opinion herein states:

> "Fourth: Taxpayer argues that since it has established both conditions precedent for the use of § 722, the tax must be determined by the constructive average. With this we agree."

May we submit that if the principle of liberal construction be here applied, would not the constructive average be computed in accordance with the method prescribed by

section 713 (e) in order that the statute may give the relief it was intended to provide?

Respectfully submitted,

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